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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 765

JAMES PETROLEUM CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Of Counsel

THE COURT PRESS, 130 Cedar Street, N. Y. C.

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No.

JAMES PETROLEUM CORPORATION,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit entered in this case.

Opinions Below

The opinion of the Tax Court (53a-79a)[1] is reported in 24 T. C. 509.

[1] (All undesignated references are to pages of petitioners' Appendix.)

relevant rulings of the Tax Court up to that time); and its President, James, a man of a lifetime of experience in the oil business, testified that in his opinion the royalty was not worthless prior to sale (76a-78a). The Commissioner offered no testimony.

The Court of Appeals took cognizance of "the persistent but unsuccessful efforts of some other companies to find oil in this area, and the equally persistent optimism of taxpayer's president," but could not say " 'that the Tax Court's inferences and conclusions on this factual matter are so unreasonable from an evidentiary standpoint as to require a reversal of its judgment' " (83a). This last quotation was from the opinion of this Court in *Boehm* v. *Commissioner,* 326 U. S. 287, but that case was decided under the doctrine of *Dobson* v. *Commissioner,* 320 U. S. 489. The law at present merely requires a finding that the Tax Court's decision was "clearly erroneous." *U. S.* v. *United States Gypsum Co.,* 333 U. S. 364, 395.

We respectfully submit that if ever a decision of the Tax Court was clearly erroneous, it was this one. The fact that Deep Rock (a large company listed on the New York Stock Exchange) was willing to spend the money to drill a well on the property in 1946 seems the best possible evidence that the property still had value in that year. And if this were not enough, even after this fourth dry hole, another company tried again in 1950 and 1951, and finally brought in three oil wells. We cannot imagine what kind of opposing testimony the Commissioner could have offered that would have raised a substantial question of "worthlessness" here. But the amazing truth is that he offered no testimony whatever.

The Tax Court's opinion (76a) alleges in support of its finding of "worthlessness" that "the record of each of the royalty interests indicates numerous dry holes on and near the non-producing properties, and abandoned wells and dry holes on and near properties that had once produced." The opinion neglects to mention that these records also show many producing wells and existing leases. But the drilling of "numerous" dry holes is a striking example of the fundamental fallacy of the whole theory of the Tax Court's decision. For the fact that operators are willing to go on drilling still another well after a number of failures in the vicinity show how difficult if not impossible it is to determine "worthlessness" on the basis of dry holes. The opinion treats as of no consequence the fact that producing wells were drilled and leases made on these royalties after their sale, because the taxpayer failed to prove that these wells and leases were valuable. But surely the fact that oil men were spending time and money on properties is enough to prove that these properties were not absolutely worthless. The respondent himself admitted in his brief below that "royalty interests may perhaps always have a possibility of value."

From 1913 to 1941, the Board of Tax Appeals followed the rule stated as follows in *Roy Nichols,* 17 B. T. A. 580 (Acq. IX-1 C. B. 40), at p. 583:

> "* * * They were interests in royalty rights and not oil and gas leases. Interests in royalty rights are interests running with the land, and unless specifically limited as to time or otherwise, are not forfeitable. They may become unsalable, dormant for a time as it were, but still remain an asset, an asset of questionable value it may be,

> but nevertheless an asset, that may become valuable any day, and hence may not be deemed such an ascertained loss as to be deductible in determining net profits for taxation purposes."

However, in *Chapparal,* 43 B. T. A. 457, a *taxpayer* was permitted for the first time to write off and deduct a royalty which it determined to be worthless. This modification of the rule was followed in *Harmon,* 1 T. C. 40, and *Heller,* 1 T. C. 222. But the Tax Court refused to declare royalties worthless upon the *Commissioner's* determination, prior to sale, in *Paramount Royalties, Inc.,* 1940 P-H B. T. A. Memorandum Decision, Para. 40,145 and *Royalty Corporation of America,* 6 T. C. M. 703, even though there, in addition to the "evidence" of prior worthlessness thought to be found in the instant case by the Tax Court in the small sales prices, the Commissioner produced expert testimony to support his stand.

In *Paramount Royalties, Inc., supra,* where royalties costing over $4,000. were sold for $9., Judge Kern said:

> "In *Roy Nichols,* 17 B. T. A. 580, the taxpayer owned royalty interests in certain tracts located in 'wild cat' oil territory. Wells were dug thereon but proved to be dry. Thereafter there was no market for the taxpayer's interests. However, he continued to hold these royalty interests and we affirmed respondent's determination that the taxpayer coull not deduct any loss arising from their alleged worthlessness because the loss was not ascertained, thus implicitly applying the general rule above stated to a situation which is, in general, similar to the situation pres-

ent in the instant case. The necessary corollary to our holding in that case would be that when the taxpayer did dispose of the royalty interest and the loss was fixed by a closed transaction, it would then be deducted. * * * Under these circumstances, it is our conclusion that the rule implicit in our decision in Roy Nichols, supra, is applicable and that petitioner is entitled to deduct its losses in the year in which the losses were definitely fixed by reason of the sale of its royalty interests."

In *Royalty Corporation of America, supra,* Judge Murdock said:

"The question of the value of oil and gas royalties is largely a matter of opinion. Opinions in evidence as to the continuing value of the royalties here in question differ. Some would apparently have deemed those here in question worthless in 1929 or would have concluded in 1929 that there would never be any commercially profitable production obtained from them. The petitioner, however, acting honestly in accordance with the best judgment of its officers and advisers, did not conclude that these particular royalties were worthless in 1929 or at any time. Cf. *Rhodes* v. *Commissioner,* 100 Fed. (2d) 966. Instead, the petitioner retained them as assets of some value on its books until it sold them in 1941 in a *bona fide* sale to a stranger for a $225. gross sales price. No ulterior purpose in doing this appears. The evidence shows that this action was not unreasonable. Here, where it does not appear that the royalties were ever clearly or actually worthless, the sale is a satisfactory occasion upon which to base a deduction."

This is the first case in which the considered judgment of the taxpayer, proved to be right by subsequent events, has been retroactively set aside by governmental fiat, and a fictitious "worthlessness" imposed on an owner of realty against his will, where none in fact existed.

A recent study (34 Taxes (The Tax Magazine) 311, May, 1956) shows that the Second Circuit Court of Appeals has a substantially higher than average percentage of affirmances of Tax Court decisions adverse to taxpayers. The present case seems thus to be symptomatic of a general trend, which deprives the taxpayers of the Second Circuit of the right of review intended by Congress and this Court. We submit that even had this been an appeal from an administrative tribunal, where the scope of review is more limited, the decision below would appear to have "misapprehended or grossly misapplied" the standard fixed by this Court in *Universal Camera Corp.* v. *National Labor Relations Board,* 340 U. S. 474 (on certiorari to the Second Circuit Court of Appeals); cf. p. 491.

2. The Conflict of Circuits

While this is the first case in which alleged "worthlessness" of the particular kind of realty interest represented by a perpetual oil royalty has come before a Court of Appeals, numerous cases involving realty in general have been decided by Courts of Appeals in other circuits, and their decisions have been uniformly in conflict with the instant one. These other Courts of Appeals have worked out special

criteria peculiarly applicable to realty, which are in sharp conflict with the holding below.

The Courts of Appeals have been extremely reluctant to allow losses so long as the taxpayer retains title, and have limited such allowances to a few exceptional cases where the following circumstances concur:

> (1) large tax or mortgage liens, exceeding the market value of the property and constantly growing; (2) imminent foreclosure; (3) voluntary abandonment by the taxpayer of all interest in the property; and (4) a write-off of it as absolutely worthless at or before the end of the tax year.

The cases which established the above standards are:

Denman v. *Brumback* (C. A. 6), 58 F. 2d 128;
Rhodes v. *Commissioner* (C. A. 6), 100 F. 2d 966;
Commissioner v. *Peterman* (C. A. 9), 118 F. 2d 973;
Bickerstaff v. *Commissioner* (C. A. 5), 128 F. 2d 366;
Commissioner v. *McCarthy* (C. A. 7), 129 F. 2d 84;
Helvering v. *Gordon* (C. A. 4), 134 F. 2d 687.

In *Helvering* v. *Canisteo Mining Co.* (C. A. 8), 76 F. 2d 378, where the mineral lessee decided to abandon a lease, and gave the required six months' notice terminating it on January 1, 1927, the Court held that the loss was deductible in 1927, as the taxpayer

claimed, rather than in 1926, the scintilla of title remaining on New Year's Day preventing earlier worthlessness.

In *Louisiana Land & Exp. Co.* v. *Commissioner* (C. A. 5), 161 F. 2d 842, 844, 845, the Court cited with approval certain cases cited *supra* which permitted the taxpayer to deduct as worthless royalties which he abandoned and wrote off.

Commissioner v. *Hoffman* (C. A. 2), 117 F. 2d 987, is the only case in the Second Circuit which permitted a deduction for worthless realty. There the four essentials above listed were all present. In *Commissioner* v. *Abrahamson* (C. A. 2), 124 F. 2d 416, the Court said: "We are not disposed to extend the decision in the *Hoffman* case beyond its own facts." But in the instant case the Court has carved out an exception to the fundamental principle adopted in the other Circuits as to deducting realty losses, and has imposed a finding of prior worthlessness in the absence of any of the four circumstances whose concurrence was hitherto deemed essential. There seems to be no logical basis for singling out oil royalties for special treatment. And it seems strange to declare an interest absolutely worthless when it is perpetual and indestructible, not subject to taxes or mortgages, and held by its experienced owner over a long period of years with the expectation of ultimate oil discovery, which was proved by the event to be justified.

The Court below cites *Helvering* v. *Gordon, supra,* as holding that "even in real property cases abandonment is not a prerequisite, but merely evidence of worthlessness." But in fact what the Court said in

that case was that "divestiture of legal title is not essential if worthlessness is otherwise satisfactorily established." And the Court found that worthlessness *had* been satisfactorily established by proof of the four essentials above specified. Hence the *Gordon* case, like all the other cases from other Circuit Courts of Appeals cited above, held that abandonment *was* a necessary prerequisite to allowance of a deduction for worthlessness, though of course it was not *per se* sufficient to establish it, because the other three essential elements of proof were also required. Hence the "optimism" of taxpayer's president (which we assume meant his expert judgment that the royalty might produce oil, which was later proved correct) which the Court below regarded as unimportant, would be held in the Fourth, Fifth, Sixth, Seventh, Eighth, and Ninth Circuits as conclusive proof leading to a contrary result.

The citation of the *Gordon* case as a supporting authority in the opinion below is the more curious for the following reason. The Commissioner there contended that "so long as a taxpayer retains title to such property" (as realty) "he is in a position to profit from future favorable developments," and the Court assumed *arguendo* the validity of this contention as to an "unencumbered interest in land" (134 F. 2d 687). We submit that taxpayer's royalty here is a perfect example of that type of property.

3. The Question Is Important

Apart from the conflict between the Second Circuit and several others the point involved is of great importance in the administration of the income tax law. The attitude of the Commissioner places an impossible burden on the small individual or corporate royalty owner, who (if the evidence of non-worthlessness here adduced is unavailing) would be required to engage in a doubtful and expensive duel of experts to overcome the presumptively correct finding of the Commissioner. On the other hand, large companies, with scores of experts on their pay-rolls, will be able as a practical matter to take losses when they please, while still retaining ownership,—to eat their cake, and have it too. In view of the enormous part played by oil in our national economy, it is evident that this new windfall (in addition to the other special tax privileges enjoyed by oil operators) may in the long run prove extremely costly to the Treasury. Furthermore, return to the pre-1941 rule, which had apparently been approved by Congress as evidenced by numerous Revenue Acts enacted during that period, would not only conform to the practical realities of life, where we know that a perpetual possibility of value is incompatible with utter worthlessness, but also promote simplicity and efficiency in administration, by lessening if not abolishing altogether in this field the unsatisfactory battles of opposing experts. We submit that the rule long established in the majority of Circuits as to real estate should be sustained, and the anomalous exception engrafted on it by the decision below removed.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

WATSON WASHBURN
Counsel for Petitioner

WASHBURN & GRAY
Of Counsel

February 4, 1957.

Opinion of United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 28—October Term, 1956.

(Argued October 9, 1956 Decided November 13, 1956.)

Docket No. 24083

JAMES PETROLEUM CORPORATION,
Petitioner,

—v.—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before:

CLARK, *Chief Judge,* and
L. HAND and SWAN, *Circuit Judges.*

Petition for review of a decision of the Tax Court of the United States, Bolon B. Turner, *Judge.*

James Petroleum Corporation petitions for review of a decision, 24 T. C. 509, finding deficiencies in its income taxes for 1947 and 1948 in the amount of $8,355.86 upon disallowing its claimed deductions for losses of oil royalty interests and for depletion on such interests. Affirmed.

WATSON WASHBURN, of Washburn & Gray, New York City, for petitioner.

MELVA M. GRANEY, Atty., Dept. of Justice, Washington, D. C. (Charles K. Rice, Asst. Attorney General, Lee A. Jackson and Hilbert P. Zarky, Attys., Dept. of Justice, Washington, D. C., on the brief), for respondent.

CLARK, *Circuit Judge:*

This petition for review of a decision of the Tax Court, 24 T. C. 509, assessing deficiencies against the petitioner-taxpayer in its income taxes for 1947 and 1948 raises issues as to the disallowance of its claimed deductions for losses of oil royalty interests and for depletion of such interests. On the first point petitioner contests the conclusion of the Tax Court that oil royalties which it sold for a nominal amount had become worthless prior to the year of sale and consequently did not give rise to deductible losses in that year under §23(f) of the Internal Revenue Code of 1939.[1] On this issue petitioner had the burden of

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[1] 1939 Internal Revenue Code:

Sec. 23. Deductions from Gross Income.

* * * *

(f) Losses by Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Treasury Regulations 111:

Sec. 29.23(e)-1(b). In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses.

showing that the losses occurred in the year of sale, and the Tax Court was not obliged to identify the year in which the properties became worthless in order to find that they had become worthless prior to the year claimed by the taxpayer. *Boehm* v. *Commissioner*, 326 U. S. 287 (1945).

The twelve royalties in question were purchased between 1927 and 1929 at prices from $14,761.35 to $1,121.42, and were sold in 1946, 1947, and 1948 at prices between $40 and $1. The wells underlying five of the royalties never produced oil; six of the properties produced at one time but drilling operations had been abandoned prior to the date of sale; and one was in a tract in which production had steadily dwindled from a peak of 226.36 barrels the year after purchase to 4.16 barrels in the year of sale. Between 1927 and 1948 numerous dry holes were drilled in and near the properties of the taxpayer. The taxpayer tried to establish the continuing worth of the royalties at the time of sale by evidence of the persistent but unsuccessful efforts of some other companies to find oil in this area and the equally persistent optimism of taxpayer's president. We cannot say, however, "that the Tax Court's inferences and conclusions on this factual matter are so unreasonable from an evidentiary standpoint as to require a reversal of its judgment." *Boehm* v. *Commissioner*, *supra*, at 294.

We are asked by taxpayer to declare that oil royalty interests are incapable of becoming worthless while the owner retains legal title to them and thus to

avoid the hardship involved in requiring owners to determine the precise year of worthlessness. The argument has long been rejected by the Tax Court and the Board of Tax Appeals, e. g., *Chaparral Oil Co.* v. *Commissioner,* 43 B. T. A. 457, *appeal dismissed* 122 F. 2d 933 (10 Cir. 1941); *Harmon* v. *Commissioner,* 1 T. C. 40 (1942), *aff'd on another issue* 139 F. 2d 211 (10 Cir. 1943), *rev'd* 323 U. S. 44 (1944); *Heller* v. *Commissioner,* 1 T. C. 222 (1942). Moreover, the clear words of the statute and the Regulations require the loss to be deducted in the year when it is sustained rather than in the year when the taxpayer chooses to recognize it.

Nor is a different result required if these royalty interests are treated as real property. Taxpayer contends that real property has never been held to become worthless while the owner retains legal title unless there has been an abandonment by the taxpayer and a write-off on his books, neither of which were present here. But even in real property cases abandonment is not a prerequisite, but merely evidence of worthlessness. *Helvering* v. *Gordon,* 134 F. 2d 685 (4 Cir. 1943). For the purpose of determining the year in which a loss was sustained it is not significant whether the royalty was realty or personalty. *Commissioner* v. *Hoffman,* 117 F. 2d 987 (2 Cir. 1941). An oil royalty interest is only a right to share in oil and gas if and when produced, and the taxpayer's failure to abandon such property does not conclusively establish its worth any more than a similar failure to abandon shares of stock establishes that the shares still have value. Cf. *Boehm* v. *Commissioner, supra.*

The other items of dispute between taxpayer and Commissioner similarly hinge on the latter's unwillingness to share the optimism of taxpayer's president about the chance of producing oil from the land in which taxpayer held leases and royalties.

Here, too, the Tax Court's findings were grounded on substantial evidence. The disallowance of the loss deduction on the Gilbreath royalty and the disallowance of the depletion claimed under Section 113(b)(1)(B) of the 1939 I. R. Code must stand.

Affirmed.

Judgment

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 13th day of November one thousand nine hundred and fifty-six.

Present: HON. CHARLES E. CLARK,
Chief Judge
HON. LEARNED HAND,
HON. THOMAS W. SWAN,
Circuit Judges

JAMES PETROLEUM CORPORATION
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed,

A. DANIEL FUSARO
Clerk

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

FILED Nov. 13, 1956

A. DANIEL FUSARO CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 765

JAMES PETROLEUM CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 53a–79a)[1] are reported at 24 T. C. 509. The opinion of the Court of Appeals (Pet. 81a–85a) is reported at 238 F. 2d 678.

JURISDICTION

The judgment of the Court of Appeals was entered on November 13, 1956. (Pet. 86a–87a.) The petition for a writ of certiorari was filed on February 11, 1957. The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

[1] Record references are to the pages of the appendix to taxpayer's brief below.

QUESTION PRESENTED

Taxpayer claimed loss deductions, under Section 23 (f) of the Internal Revenue Code of 1939, on certain royalty interests which it sold in the taxable years 1946, 1947, and 1948 for nominal amounts. The question is whether the court below erred in affirming the Tax Court's conclusion that the royalty interests became worthless, and that the losses were therefore sustained, prior to the taxable years.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.
>
> * * * * *
>
> (26 U. S. C., 1952 ed., Sec. 23.)

STATEMENT

The pertinent findings of fact of the Tax Court on the single issue raised in the petition may be summarized as follows:

The taxpayer is a Delaware corporation which was organized in 1927 and was in the business of dealing

in oil properties. It has always carried its oil properties on its books at cost, less adjustments for depreciation and depletion, until the properties are disposed of by sale. (R. 55a.)

In the years 1946, 1947 and 1948, taxpayer purportedly sold five non-producing and six once-producing oil royalty interests for amounts ranging from $1 to $40. The following table reflects the Tax Court's findings (R. 61a–66a) as to the year of purchase, purchase price, drilling activity, year of sale and sale price with respect to each royalty interest:

NON-PRODUCING ROYALTY INTERESTS

No.	Yr. of purchase and cost	Drilling on or adjacent to properties	Yr. of purported sale and sale price
86	1928—$2,500.50	1 dry hole, 1928 1 dry hole, 1929 1 dry hole, 1942 1 dry hole, 1946 3 producing wells, 1950–1951	1946—$1.
120	1928—$2,588.75	1 dry hole, 1930 3 dry holes, 1939 1 dry hole, 1943	1946—$1.
98	1928—$1,571.80	1 dry hole, 1928 1 dry hole, 1929	1947—$20
206	1929—$2,200.00	1 dry hole, 1938 2 dry holes, 1941 1 dry hole, 1947	1947—$20
242	1929—$13,122.75	1 producing well drilled in 1939 and subsequently abandoned. 1 dry hole, 1935 1 dry hole, 1937	1948—$1

ONCE-PRODUCING ROYALTY INTERESTS

No.	Yr. of purchase and cost	Drilling Activity	Yr. of purported sale and sale price
1	1927—$2,371.60	3 wells drilled on the property from 1926 to 1928 from which there was some production in 1927 to 1933, inclusive, but wells have since been abandoned.	1946-$1
2	1927—$8,738.10	4 wells drilled on the property from which there was some production during 1927 and 1928, but wells have since been abandoned.	1946—$1
24	1928—$5,131.80	6 producing wells and one dry hole drilled on property. Of 6 producing wells, some were abandoned prior to taxpayer's purchase of royalty interest and the others were subsequently abandoned. Property had some oil production for each of years 1928 to 1940, inclusive.	1947—$10
171	1928—$1,902.83	1 dry hole drilled prior to purchase by taxpayer. 2 dry holes, 1929. 1 well from which some oil was produced in 1929 and 1930.	1947—$20
180	1928—$14,761.35	1 well drilled in 1928 from which some production was obtained in 1928 and 1929. 1 dry hole, 1929.	1947—$40
284	1928—$1,121.42	2 wells drilled in or prior to 1933 from which some production was obtained in 1933 to 1936, inclusive. Property leased to one lessee terminating in December 1937 and to another lessee terminating in April 1940.	1946—$2

Taxpayer claimed loss deductions on the above royalty interests in the years of their purported sale, and the Commissioner disallowed the deductions on the basis of a determination that the losses were sustained prior to the taxable years because the royalty interests had become worthless prior thereto. (R. 64a, 75a.) The Tax Court sustained the Commissioner's action, concluding that the royalty interests had become worthless prior to the purported sale

years (R. 75a–78a), and the Court of Appeals affirmed that conclusion (Pet. 81a–85a).[2]

ARGUMENT

As grounds for granting the writ, taxpayer asserts that the Court of Appeals' affirmance of the Tax Court's decision "amounted to an abdication of its duty of review", that the decision below is in conflict with decisions of other Courts of Appeals, and that the question presented is an important one which should be settled by this Court. (Pet. 3.) These assertions are incorrect.

1. The alleged "abdication" by the court below "of its duty of review" is based on taxpayer's own belief (Pet. 4) that the decision of the Tax Court was "clearly erroneous". In support of that view, taxpayer points to the opinion of its president that the royalty interests did not become worthless prior to the taxable years and to the fact that the parties who drilled the dry holes were "willing to spend the money" on drilling.[3] (Pet. 4.) The drilling of dry

[2] The Commissioner had disallowed a loss deduction on still another royalty interest, No. 10, on which production dwindled to 4.16 barrels in the year of sale. (See R. 66a–67a.) This royalty interest was excepted from the Tax Court's conclusion of worthlessness (R. 78a) and was not involved on appeal except in relation to a depletion question not raised in the instant petition.

[3] Taxpayer also states, at two points, that the expectation of ultimate oil discovery was justified by subsequent events (Pet. 8, 10), but those statements are unwarranted. They apparently have reference to the fact that, in respect of one of the properties (No. 86), drilling in 1950 and 1951 (which was after taxpayer's sale of the royalty interest in 1946 for $1) "finally brought in three oil wells." (Pet. 4.) As the Tax Court stated (R. 77a), there is no evidence that the oil from such wells was available in sufficient quantities to give value to the property.

holes did not absolutely preclude all speculative possibility of value, but absolute certainty is not required. The question whether a loss is sustained in a particular year is "purely a question of fact" which "of necessity requires a practical approach". *Boehm* v. *Commissioner,* 326 U. S. 287, 292–293. "The Taxing Act does not require the taxpayer to be an incorrigible optimist". *United States* v. *White Dental Co.,* 274 U. S. 398, 403. Taxpayer's losses on the royalty interests were sustained when they became "*reasonably* certain in fact and ascertainable in amount" (italics supplied). *Lucas* v. *American Code Co.,* 280 U. S. 445, 449; *United States* v. *White Dental Co., supra.* The court below held in substance that the decision of the Tax Court was not clearly erroneous (Pet. 83a), and that conclusion is amply supported by the drilling of dry holes and abandonment of once-producing wells.

2. The decision below is not in conflict with the various decisions cited by taxpayer (Pet. 8–11) as establishing a standard to be applied in determining worthlessness. The cited decisions did not purport to lay down any fixed standard governing cases, such as the present one, involving the worthlessness of royalty interests. Moreover, as this Court stated in *Boehm* v. *Commissioner,* 326 U. S. 287, 293, "The standard for determining the year for deduction of a loss is * * * a flexible, practical one, varying according to the circumstances of each case".

3. This case, involving as it does an appraisal of a particular factual situation, does not present an issue which merits further review by this Court. In cases

involving the worthlessness of oil interests, the drilling of a dry hole or holes is cogent evidence of worthlessness and has been so recognized for some time.[4]

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[4] See G. C. M. 3890, VII–1 Cum. Bull. 168 (1928); *Chaparral Oil Co.* v. *Commissioner*, 43 B. T. A. 457; *Harmon* v. *Commissioner*, 1 T. C. 40, affirmed on another issue, 139 F. 2d 211 (C. A. 10th) reversed, 323 U. S. 44; *Heller* v. *Commissioner*, 1 T. C. 222; *Moore* v. *Commissioner*, decided December 19, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,656); *Pilot Royalty Co.* v. *Commissioner*, decided December 19, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,665); *Foster Investment Corp.* v. *Commissioner*, decided December 19, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,664); *Randolph* v. *Commissioner*, decided December 21, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,666); *Horsting* v. *Commissioner*, *decided* May 27, 1946 (1946 P–H T. C. Memorandum Decisions, par. 46,123); *Findley* v. *Commissioner*, decided April 18, 1951 (1951 P–H T. C. Memorandum Decisions, par. 51,110); *Byerlein* v. *Commissioner*, 13 T. C. 1085.

CONCLUSION

The decision below is correct, there is no conflict of decisions, and no other reason exists which warrants further review by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 765

JAMES PETROLEUM CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENT TO BRIEF FOR THE RESPONDENT IN OPPOSITION

In its reply brief, taxpayer asserts that a direct conflict with the decision below is created by the recent decision of the Seventh Circuit in *Davis* v. *Commissioner,* decided March 1, 1957 (1957 P-H, par. 72,517). The assertion is without merit.

The *Davis* case is merely one in which a different result was reached on different facts. Recognizing that the year for deduction of a loss "is one of fact controlled by evidence in the particular case," the Seventh Circuit held that "[t]he abandonment of one well on a total of 1280 acres is not proof of the worthlessness of an oil lease upon the entire acreage" when "only one well had been driven, on one of the two sections," when the parties immediately made appli-

cation for and obtained new leases, and when "complete exploration of the possibilities for production of oil and gas on 1280 acres had not been explored or ascertained." In contrast, the present case involves the drilling and abandonment of numerous non-producing and once-producing wells long prior to the taxable years without, so far as appears, any intention on the part of the lessors to continue exploratory operations.

Respectfully submitted.

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Since the taxpayer filed its petition, a direct conflict with the decision below has been established by the Seventh Circuit Court of Appeals in *Davis* v. *Commissioner*, decided March 1, 1957, and unofficially reported in 57-1 USTC Paragraph 9441, reversing 34 T. C. M. 1033.

The Tax Court, largely relying on *James Petroleum Corporation*, 24 T. C. 509, had held that where a dry hole was drilled in 1944, and taxpayer's lease expired January 1, 1945, the Commissioner rightly treated the loss as sustained in 1944, and not in 1945, as the taxpayer claimed.

In reversing, the unanimous opinion of the Court of Appeals said:

"* * * As long as the lease was in effect, there

was a possibility that other wells on the section in which the one well had been driven and on the other sections on which no well had been drilled might result in finding oil and gas in productive quantities. Consequently, it cannot be said that the leases were worthless. The abandonment of one well on a total of 1280 acres is not proof of the worthlessness of an oil lease upon the entire acreage. That the parties continued to believe in such possibilities is evident from their applications for and allowance of new leases. Consequently, this lease, not made worthless by the drilling of one well, was of some value at all times until it expired, and the Tax Court, we think, was not justified in saying that stopping work on the one well was an abandonment of the entire leasehold, and proof of the lack of value of the entire lease at that time. The identifiable event, in our opinion, irrespective of the stipulation of the parties to that effect, but as a matter of law, upon the undisputed facts, was the time of the closed transaction, that is, the year 1945. Until that time plaintiff retained an interest in the lease, the possibilities of which had not been exhausted."

The present taxpayer's case is of course much stronger, in that it owned perpetual royalty interests, rather than a lease with only a day to run.

Respectfully submitted,

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March 15, 1957.